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FOR EB ASSISTANT SECRETARY SULLIVAN

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SUBJECT: SCENESETTER FOR A/S SULLIVAN

REF: A. ANKARA 3896

[1](#)B. ANKARA 3717
[1](#)C. ANKARA 3644

[1](#)1. (SBU) Summary and Introduction: Your visit to Ankara is an opportunity to send a message of confidence in Government and Central Bank stewardship of the economy while privately passing on U.S. investors' concerns. Coming right after FonMin Gul's visit to Washington, your Ankara stop helps us reinforce the economic component of the just-announced Shared Vision and Structured Dialogue. Your visit also provides an opportunity to exchange views on important trade issues, press for a stronger regime against terrorism finance and action on Iraq debt, and discuss the Economic Partnership Commission.

[1](#)2. (SBU) Your visit to Ankara is well-timed to give a supportive public message showing U.S. confidence in the Government and the Central Bank's stewardship of the economy. In private, you could usefully pass on U.S. investor concerns about Turkish officials' public statements in June that failed to convey the sense that investors' concerns were understood. Regarding the EU accession process, a message of restraint in publicly reacting to perceived EU slights and in quickly advancing on other, non-pressing EU agenda items in a strategy to win allies would help both with the EU process and with financial markets.

[1](#)3. (SBU) The unremitting negativity in markets for most of May and June has at least temporarily subsided. Since the Central Bank hit the markets early last week with a package of intervention, foreign exchange auctions, rate hikes and lira deposit auctions, the lira has stopped sliding and has even appreciated a bit, helped along by the Fed statement and surprisingly benign June inflation numbers. End Summary.

Turkey Still Committed to Program

[1](#)4. (SBU) The communication missteps and a sense that the new Central Bank leadership was behind the curve in recent months has masked what remains broadly speaking a good economic reform story, as IMF Deputy M.D. Krueger pointed out in her June 29 speech in Istanbul. The Government

has recently recommitted to the IMF program in general and to fiscal discipline in particular. In a bid to reassure markets, the Government is now talking about achieving a 6.7% of GDP primary surplus -- surpassing the existing 6.5% target. At 6.5%, the primary surplus would already be one of the most fiscally austere in the world. The Government deserves credit for sticking to fiscal discipline as it heads into an election year in a domestic political context of rising nationalism and opposition bashing of the IMF and the EU. An IMF Mission left Ankara in May, confident of the government's current commitment to the stand-by program -- a view we share. The IMF board is expected to meet at the end of July or beginning of August to approve the third and fourth reviews under the program and release approximately \$1.6 billion in financing.

European Union

15. (SBU) Since Turkey became an accession country on October 3, 2005, tensions with the EU have mounted. The issue of Turkey opening its ports and airports to Cypriot ships and planes looms as an imminent threat to Turkey's EU accession process in the fall. Uncertainty over this issue is an important worry in financial markets, as the EU accession process "anchors" Turkey on a reformist, modernizing, western-oriented track. With elections (both presidential and parliamentary) next year, decreased domestic support for EU accession and rising nationalism, the Government can ill-afford to make additional concessions on Cyprus without some political cover in the form of EU movement to help reduce the economic isolation of northern Cyprus.

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Political Context

16. (SBU) You are visiting during a time of renewed political tensions in the run-up to presidential and parliamentary elections scheduled for May and November 2007, respectively. Tensions have been building between secular forces and the pro-Islam ruling Justice and Development (AK) Party, particularly in May after a dramatic assassination of a senior judge by an individual allegedly professing religious motives (but with apparent nationalist credentials). The earlier controversy over the appointment of a new Central Bank governor was another manifestation of this tension. Having taken office at a time when inflation fears have re-emerged, this will make it even more difficult for Governor Yilmaz to reestablish the Bank's inflation-fighting credibility. Combined with the uncertainties in global markets that appear to have triggered the recent market correction, political uncertainties thus seem likely to generate more turbulence in the coming months.

Bilateral Relationship

17. (SBU) A strong relationship with the U.S. is a necessary ingredient of stability in Turkey and the region. It helps, among other things, offset the current uncertainties about the EU. Secretary Rice has made considerable

progress in restoring an atmosphere of shared effort and partnership that includes Turkey's valuable contributions in Afghanistan and Iraq (although Turkey has not signed on to debt reduction to Iraq) as well as to the international diplomatic effort to convince Iran to drop its nuclear ambitions. We are working together against the PKK in Iraq and its support networks in Europe. Coming right after FonMin Gul's visit, your visit helps us reinforce the economic component of the "Shared Vision and Structured Dialogue." The always energetic and creative Turkish press will be keen to read some kind of deeper meaning into your visit. To the extent that your public comments put your meetings into this context of shared interests and consultations among allies, as well as your confidence in the sound economic policies that have fostered success thus far, it will help to put to rest any misguided conspiracy theories.

Economic Partnership Commission

¶8. (SBU) In your meetings at MFA, it is important that you be prepared to discuss the EPC, even if only in a preliminary way. With no EPC having been held since December, 2003, one is long overdue and is specifically referenced in the Structured Dialogue paper announced at the Gul visit. We should make the best use of the EPC, both as a forum to discuss bilateral economic issues and try to achieve some focus on both sides, but also as a symbol of our commitment to putting economic flesh on the strategically-oriented "bones" of the bilateral relationship. You will find the MFA very receptive, albeit not economically-savvy.

Trade and Investment

¶9. (SBU) Bilateral trade totals about \$10.2 billion, with \$5.3 billion in U.S. exports and \$4.9 billion in U.S. imports from Turkey. Trade with the U.S. accounts for 6.7% of Turkey's exports and 4.6% of Turkey's imports. Roughly half of Turkey's trade is with the EU. Trade Minister Tuzmen has dubbed 2006 the "Year of the Americas" and the Turkish Government is trying to expand exports to the U.S. by focusing on a few target states. The U.S. has longstanding concerns about Turkey's trade and Intellectual Property policies, including WTO-inconsistent barriers to U.S. agricultural products and significant problems with

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intellectual property protection in the pharmaceutical sector.

¶10. (SBU) The investment climate has improved in recent years, in part due to the Government's strongly pro-business, pro-foreign investment, pro-privatization stance. These policies brought in \$9.6 billion in FDI in 2005, a number that is expected to be surpassed in 2006. The Government deserves credit for encouraging privatization and foreign investment despite popular skepticism and political opposition. Though some U.S. companies continue to experience problems with the courts and regulators, the list of intractable U.S. company problems has shortened in recent years. The strong growth in the economy -- it averaged 7.5% a year from 2002 through 2005 -- has shifted the focus from problems to opportunities

Terrorism Finance: Keeping the Profile up and the Pressure on

¶11. (SBU) Except for a small group of officials directly

responsible for the issue, the political level seems indifferent to the issue, despite the GOT's overall commitment to fighting global terrorism. Turkey's regime is weak but the Government seems to think it will be taken care of with the long-delayed passage of a law reorganizing Turkey's financial intelligence unit (MASAK). Though the law includes important reforms (explicitly criminalizing the financing of terrorism and providing immunity from prosecution for bank filers of suspicious activity reports) and was submitted to parliament in November 2005, the parliament has recessed until October without passing it. Turkey is likely to fare very badly in its Financial Action Task Force peer review which will begin in September. You should urge rapid passage of the law but also a broader focus on meaningful implementation.

Iraq Debt

¶12. (SBU) Turkey has not agreed to provide debt treatment to Iraq comparable to Paris Club terms of 80% forgiveness. In fact, there is no specific official position yet but Turkey has no history of debt forgiveness and there is a strong bias (delusion?) in favor of merely rescheduling the debt. Turkey is unaccustomed to thinking of itself as a creditor country and Turks have a tendency to view Iraq as a potentially rich country and themselves as a country with financial difficulties. Moreover, Iraqi authorities have yet to push the debt issue in a meaningful way with Turkey. One positive development is that Minister of Economy Babacan, the minister with the most experience in international financial fora, has recently taken the lead on the issue. It would be useful for you to urge Turkish officials to help stabilize Iraq by providing treatment comparable to Paris Club terms, which Iraq is required to seek from all creditors.

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